GOVERNOR GRANHOLM'S FY 2004-05 BUDGET

OVERVIEW OF RECOMMENDATIONS

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The Governor's FY 2004-05 budget recommendation contains proposed State revenue increases, proposed fee increases, increases and reductions in State appropriations, assumptions concerning the utilization of Federal funds, assumptions concerning State employee salary and fringe benefit cost increases and the transfer of State restricted funds to balance the State budget.

The Governor's FY 2004-05 budget recommendation is based on the consensus revenue estimate reached on January 14, 2004. The FY 2004-05 General Fund/General Purpose (GF/GP) consensus revenue estimate is $7.82 billion. This estimate represents a 0.4% decline from the consensus estimate of FY 2003-04 GF/GP revenues. The FY 2004-05 School Aid Fund consensus revenue estimate is $10.99 billion. This estimate represents a 3.9% increase from the consensus estimate of FY 2003-04 School Aid Fund revenues.

The Governor's FY 2004-05 budget recommendation contains the following levels of appropriations:

Adjusted Gross	$39.1 billion
State Spending from State Resources	$26.0 billion
General Fund/General Purpose	$8.7 billion
Full-Time Equated Positions	56,793

Adjusted Gross appropriations represent a $648.3 million or 1.7% increase from FY 2003-04 year-to-date appropriations. State Spending from State Resources appropriations represents a $444.5 million or 1.7% increase from FY 2003-04 year-to-date appropriations. GF/GP appropriations represents a $210.3 million or 2.4% decline from FY 2003-04 year-to-date appropriations and the appropriated level of Full-Time Equated positions represents a 865.5 or 1.5% decline from FY 2003-04 year-to-date appropriations.

Table 1

Adjusted Gross Appropriation History (millions of dollars)			
Fiscal Year	**Appropriations**	**Dollar Change**	**Percent Change**
1997-98	31,472.8	1,816.3	6.1%
1998-99	33,160.3	1,687.5	5.4%
1999-2000	35,417.7	2,257.4	6.8%
2000-01	37,052.8	1,635.1	4.6%
2001-02	38,751.3	1,698.5	4.6%
2002-03	39,553.1	801.8	2.1%
2003-04	38,442.2	(1,110.9)	-2.8%
2004-05	39,070.5[a)]	648.3	1.7%
Appropriations have increased by $2.0 billion or 5.4% from FY 2000-01 to FY 2004-05.			

Table 2

State Spending from State Resources Appropriation History (millions of dollars)			
Fiscal Year	**Appropriations**	**Dollar Change**	**Percent Change**
1997-98	22,493.6	941.3	4.4%
1998-99	23,276.8	783.2	3.5%
1999-2000	24,579.0	1,302.2	5.6%
2000-01	25,762.1	1,183.1	4.8%
2001-02	26,086.8	324.7	1.3%
2002-03	26,020.5	(66.3)	-0.3%
2003-04	25,583.0	(437.5)	-1.7%
2004-05	26,026.6[a)]	443.6	1.7%
Appropriations have increased by $264.5 million or 1.0% from FY 2000-01 to FY 2004-05.			

Table 3

General Fund/General Purpose Appropriation History (millions of dollars)			
Fiscal Year	**Appropriations**	**Dollar Change**	**Percent Change**
1997-98	8,735.1	366.0	4.4%
1998-99	9,415.0	679.9	7.8%
1999-2000	9,607.7	192.7	2.0%
2000-01	9,744.6	136.9	1.4%
2001-02	9,189.3	(555.3)	-5.7%
2002-03	8,830.9	(358.4)	-3.9%
2003-04	8,865.3	34.4	0.4%
2004-05	8,655.0[a)]	(210.3)	-2.4%
Appropriations have declined by $1.09 billion or 11.2% from FY 2000-01 to FY 2004-05.			

a) Governor's appropriation recommendation.

Table 4

FY 2004-05
General Fund/General Purpose
Revenues, Expenditures and Year-End Balance
(millions of dollars)

	Governor's Recommendation
Revenues:	
Beginning Balance	$ 0.0
Ongoing Estimated Revenues	7,822.8
Enacted Revenue Adjustments:	
Enhanced Tax Enforcement Revenue	85.1
Driver Responsibility Legislation	121.5
Driver License Fee Legislation	25.0
Escheats Law Change	15.0
Subtotal Enacted Revenue Adjustments	246.6
Proposed Revenue Adjustments:	
Increase Liquor Markup to 74%	31.8
Revenue Sharing Freeze	355.4
Suspend County Revenue Sharing Payments	183.5
Adjust Interfund Borrowing Costs	20.0
Subtotal Proposed Revenue Adjustments	590.7
Total Estimated Revenue	**$8,660.1**
Expenditures:	
Governor's Recommendation	$8,655.0
Projected Year-End Balance	**$ 5.1**

Table 5

Governor's FY 2004-05 Appropriation Recommendations
Major Proposed Changes from FY 2003-04 Year-to-Date
General Fund/General Purpose Appropriations
(millions of dollars)

FY 2003-04 Year-to-Date Appropriations	$8,865.3
FY 2004-05 Governor's Appropriation Recommendations	8,655.0
Net Decrease in Appropriations	$ (210.3)
Major FY 2003-04 Appropriation Recommendations:	
Proposed Funding Increases	$ 521.2
Proposed Appropriation Reductions	(436.3)
Fee Increases/Fund Shifts	(295.2)
Total	**$ (210.3)**

Table 6

FY 2004-05 Governor's Recommendation GF/GP Funding Increases (millions of dollars)	
<u>Department/Program</u>	
Capital Outlay	
State Building Authority Debt Service Payments................	$ 19.0
Community Colleges	
Renaissance Zone Reimbursement	0.7
Community Health	
Medicaid Caseload, Utilization and Inflation.......................	100.1
Medicaid HMO Actuarial Base Funding.............................	53.7
Community Mental Health Actuarial Base Funding	12.7
Adult Benefit Waiver Caseload...	9.7
Corrections	
Funding for 1,000 Additional Beds	13.9
Salary Step Increases Due to Seniority.............................	12.1
Hepatitis C Testing and Treatment....................................	5.6
Parole/Community Placement...	3.9
Training and Training Facility Rent....................................	1.6
Pharmaceutical Cost Increases..	1.2
Various Other Funding Increases......................................	6.1
Family Independence Agency	
Caseload Increases..	15.3
History, Arts, and Libraries	
Preservation and Access Project	1.5
Military and Veterans Affairs	
Retiree Payments..	0.2
Challenge Program	0.1
State	
Qualified Voter File..	0.4
State Police	
DNA Profiling Backlog	1.0
Treasury-Debt Service	
Quality of Life Bond Debt Service	22.2
Clean Michigan Initiative Bond Debt Service......................	3.1
Statewide Employee Economic Adjustments....................	237.1
Total Funding Increases	**$521.2**

Table 7

FY 2004-05 Governor's Recommendation
GF/GP Funding Reductions
(millions of dollars)

Department/Program	
Agriculture	
Marketing Program Elimination	$ (0.2)
Civil Service	
Reductions in Contracts, Travel and HRNM System	(0.6)
Community Health	
Pharmaceutical Savings	(16.0)
Long-Term Care Policy Changes	(10.7)
Medicaid Third Party Liability for Noncustodial Parents	(6.5)
Eliminate Managed Care from Children's Special Health Care	(3.1)
Medicaid Notification of Injury Lawsuit Settlements	(2.0)
Medicaid Emergency Room Reimbursement Rates	(3.0)
Medicaid Incontinent Supply Vendor	(1.0)
Corrections	
Western Wayne Closure and Huron Valley Transfer	(20.5)
Security Technology Enhancements to Reduce Staff	(12.8)
Education	
School Breakfast Program	(0.3)
Family Independence Agency	
Child Support Enforcement System	(2.8)
Maxey Training Center Unit Closure	(0.6)
Wayne County Foster Care Permancy Project	(1.2)
Various Other Reductions	(3.0)
Higher Education	
Michigan State University-Agricultural Experiment Station	(1.0)
Michigan State University-Cooperative Extension Service	(0.9)
Tuition Grant Program	(64.8)
Judiciary	
Court Equity Funding	(1.0)
Eliminate Existing Judgeships	(0.1)
Management and Budget	
MAIN Contract Revisions	(0.5)
Military and Veterans Affairs	
Eliminate One-Time Guard Travel for Holidays	(0.1)
School Aid Fund	
Reduce GF/GP Grant	(195.9)
State Police	
Consolidate Regional Dispatch Centers	(0.4)
Treasury-Operations	
Qualified Agricultural Loans Repayments	(3.0)
Enhanced Tax Enforcement	(0.6)
Information Technology Reductions	(0.8)
Statewide Employee Concessions	(76.2)
Statewide Information Technology Programs	(4.5)
Human Resources Optimization	(2.0)
Total	**$(436.3)**

Table 8

FY 2004-05 Governor's Budget Recommendation
Fee Increases/Funding Shifts to Increase/(Reduce) GF/GP
(millions of dollars)

Department/Program	
Community Health	
Vital Record Fee Increase	$ (1.5)
Tobacco Tax Revenue to Offset GF/GP Medicaid	(419.1)
Tobacco Settlement Revenue Fund Shifts	(68.2)
Estate Tax Revenue to Offset GF/GP Medicaid	(94.3)
Replace One-Time Federal Medicaid Funds with GF/GP	168.4
Medicaid Match Rate Increased Federal to Reduce GF/GP	(65.8)
Replace Medicaid Federal Special Financing with GF/GP	152.6
Mental Health Quality Assessment Program	(3.5)
Pharmacy Quality Assessment Shift to GF/GP	18.9
HMO Quality Assessment Adjustments	(18.5)
Corrections	
Parole/Probation Fees to Offset GF/GP	(0.5)
Resident Stores Revenue Increase	(0.3)
Annualize Public Works Fee Increase	(0.1)
Youth Prison Replace Federal with GF/GP	18.0
Education	
Teacher Certification Fee Fund Shift	(0.6)
Environmental Quality	
Drinking Water Revolving Loan Program Shift to Restricted	(16.3)
Family Independence Agency	
Replace Federal CSES Revenue with GF/GP	14.1
History, Arts and Libraries	
Replace Federal for Detroit/Grand Rapids Libraries with GF/GP	1.1
Judiciary	
Increase in Drug Court Fund Revenue	(0.4)
Increase in Court Equity Fund Revenue	(1.8)
Labor and Economic Growth	
Work First Program Replace Federal with GF/GP	39.9
Fire Marshall Replace GF/GP with Restricted	(1.6)
Management and Budget	
Mail Service Funding Shift	(0.2)
Natural Resources	
Purchased Lands Tax Payments Shift to Restricted	(2.0)
Forest Fire Protection Shift to Restricted	(1.0)
State	
Mainframe Computer from GF/GP to Restricted	(1.0)
State Police	
At-Post Trooper Replace with Restricted	(1.5)
Treasury-Debt Service	
Quality of Life Bonds Replace with Restricted	(10.0)
Total	**$(295.2)**

Table 9

FY 2004-05 School Aid Fund Budget Revenues, Expenditures and Year-End Balance (millions of dollars)	
	Governor's Recommendation
Revenues:	
Beginning Balance	$ 0.0
Ongoing Estimated Restricted Revenues	10,998.5
Other Revenue Adjustments:	
GF/GP Grant	131.8
Federal Aid	1,314.4
Enhanced Tax Enforcement Revenue	35.5
Proposed Revenue Adjustments:	
Liquor Markup Increase	1.7
Payment in Lieu of Taxes	(2.0)
Subtotal Other Revenue Adjustments	1,481.4
Total Estimated Revenue	**$12,479.9**
Expenditures:	
Governor's Recommendation	$12,479.9
Projected Year-End Balance	**$ 0.0**

Table 10

Governor's FY 2004-05 Appropriation Recommendations Major Proposed Changes from FY 2003-04 Year-to-Date School Aid Fund Appropriations (millions of dollars)	
FY 2003-04 Year-to-Date Appropriations	$12,376.0
FY 2004-05 Governor's Appropriation Recommendations	12,479.9
Net Increase in Appropriations	$ 103.9
Major FY 2004-05 Appropriation Recommendations:	
Foundation Allowance to $6,700	107.4
Special Education Funding	23.6
School Bond Loan Fund Debt Service	12.8
Great Parents, Great Start Program	6.7
Renaissance Zone Tax Reimbursement	6.2
Freedom to Learn Program	5.0
School Consolidation Incentive	1.0
Learn to Earn ISD Planning Grants	1.0
Pupil Membership Change from 80/20 to 50/50	(43.0)
Sec. 20J Reduction of $74 per pupil for Districts above $9,000	(6.6)
ISD General Operational Funding	(7.7)
Federal Funds Changes	(2.3)
School Lunch Program	(0.2)
Total	**$103.9**

Public School Employee Retirement System FY 2004-05 Contribution Rates: Local school districts are required to make contributions on behalf of employees to the defined benefit retirement system. During FY 2004-05, the Governor is recommending that this contribution rate be equal to 14.87% of payroll. This contribution rate represents a 1.88 percentage point of payroll increase for local school districts above the payment rate of FY 2003-04. This contribution rate increase would have been a 2.77 percentage point of payroll increase if the budget did not include a recommendation to use $145.0 million from a retirement reserve account to lessen the increase for local school districts. This reserve account will be depleted in FY 2004-05. This means local school districts could be facing retirement cost increases of approximately 4.0 percentage points of payroll in FY 2005-06.

Governor's Proposed Tax Policy Changes

Tobacco Tax Increase

- The cigarette tax would be increased $0.75 per pack from $1.25 to $2.00 per pack.
- The tax on other tobacco products (cigars, chewing tobacco) would increase from 20% to 32% of the wholesale price.
- These increases would go into effect on October 1, 2004.
- These two tax increases would also be assessed on all tobacco products held in inventory by businesses on October 1, 2004.
- The tobacco tax increases, plus the tax on inventories, would generate an estimated $295 million in additional revenue in FY 2004-05.
- An additional $35 million also would be generated in FY 2003-04 because smokers would likely increase their purchases of tobacco products in September 2004, to help avoid the tax increases that would begin in October 2004.
- The Medicaid Benefits Trust Fund would receive: 1) $265 million of the $295 million in new tobacco tax revenue, and 2) $154 million in cigarette tax revenue that is currently scheduled to go into the Budget Stabilization Fund. As a result, the Medicaid Benefits Trust Fund would receive an additional $419 million in tobacco tax revenue in FY 2004-05.
- The other $30 million in new tobacco tax revenue that would be generated in FY 2004-05, would go into the Healthy Michigan Fund.

Estate Tax Increase

<u>Background</u>

Michigan's estate tax is directly linked to the Federal estate tax, which includes a tax credit for the amount an estate pays in state death taxes. Michigan's estate tax is equal to the maximum amount an estate can claim under the Federal state death tax credit. In 2001, a 10-year phase out of the Federal estate tax was enacted, which also included a five-year phase out of the state death tax credit. As a result, Michigan's estate tax is scheduled to expire on January 1, 2005, when the Federal credit expires, although revenue from the tax will be collected through FY 2004-05. Due to this phased elimination of the Federal estate tax, Michigan's estate tax revenue, which totaled $185 million in FY 1999-2000, will decline to an estimated $34 million in FY 2004-05 and probably be close to zero in FY 2005-06.

Proposed Increase

Effective July 1, 2004, the Governor is proposing that Michigan's estate tax be decoupled from the current Federal estate tax by instead linking it permanently to most of the provisions that were in the Federal estate tax in 2001, (which were the provisions in place just before the phase-out of the Federal tax began). This new tax would include the following provisions:

- Estates valued at less than $1 million would not have to pay the tax.
- Estates valued at more than $1 million would pay a tax equal to the maximum Federal credit they could have claimed in 2001.
- Assets transferred to a spouse would continue to be totally exempt from the tax.
- Family-owned businesses, including farms, would be exempt from the estate tax.
- The Department of Treasury estimates that about one percent of decedents' estates would be subject to this proposed decoupled estate tax each year.
- At least 18 other states have already decoupled from the Federal estate tax.
- It is estimated that this change in the estate tax would generate an additional $94 million in FY 2004-05 and the Governor proposes that this additional revenue be deposited into the Medicaid Benefits Trust Fund.

Liquor Price Markup Increase

- The State of Michigan, through the Liquor Control Commission, regulates the price of liquor. Under current law, the price of liquor equals the price charged by liquor manufacturers plus a price markup of 65% for all liquor excluding beer and wine. The price of liquor paid by consumers also reflects four State specific taxes totaling up to13.85% plus the 6% sales tax.
- Proceeds from the sale of liquor are deposited into the Liquor Purchase Revolving Fund and the profits are transferred to the General Fund.
- The Governor is proposing that the State's markup in the price of liquor be increased from 65% to 74%.
- This would increase the State's liquor profit by an estimated $35.5 million in FY 2004-05.
- It is proposed that $3.7 million of these increased profits be used to fund local fire protection grants and the remaining $31.8 million would go to the General Purpose portion of the General Fund.

State Revenue Sharing Payments

The Governor's FY 2004-05 budget contains several recommended changes to the level of State revenue sharing payments to cities, villages, townships and counties. These changes include:

Advance of Collection Date for County Property Taxes. In order to offset the impact of reducing revenue sharing payments to counties, the Governor's budget recommendation for FY 2004-05 recommends that the date county property taxes are levied be permanently accelerated from December of each year to July.

- In the initial year of the acceleration, a $1.4 billion one-time increase in county property taxes would occur in FY 2003-04. The accelerated collection which would be placed in a restricted revenue fund subject to separate reporting requirements and statutory restrictions on withdrawals.

- Withdrawals in future years would be adjusted for inflation and as the fund is depleted, statutory revenue sharing payments would begin again -- sometime between approximately FY 2008-09 and FY 2026-27.

- Apparently local units could borrow against the full amount to meet cash flow needs. However, on an annual basis, no more than the allowed amount could be permanently withdrawn from the fund.

- No restrictions are placed on the timing of withdrawals or the amounts that may be withdrawn, other than on the total amount that may be permanently withdrawn during a year. A local unit could essentially receive the equivalent of a full year of revenue sharing payments on the first day of the fiscal year.

Replace payments-in-lieu-of-taxes (PILT) for State-owned land. For certain State-owned land, the State has historically made payments to local units in which the land is located to offset the reduction in property taxes that occurred when the State assumed ownership of the land. The Governor's FY 2004-05 budget proposes to permanently fund the payments to cities, villages and townships (CVTs) with statutory revenue sharing funds.

- Payments to replace PILT would be the first obligation funded with statutory revenue sharing funds. After PILT replacements are funded, the remaining portion of the statutory appropriation would be distributed according to the formula or any other provisions contained in statute.

- Taxable values used to compute payments would be fixed at the 2003 valuations and additional property the State acquires would be valued when added.

- The millage rates used to compute payments would exclude special assessments, the State education tax, and any increase in other property tax millage rates above those levied in 2003.

- The aggregate amount available to PILT replacement payments would grow at the same rate as the total of combined constitutional and statutory revenue sharing payments. Within that aggregate amount, payments would be prorated.

- No payments would be made to any jurisdiction where the PILT replacement would be less than $500 during a fiscal year.

- PILT payments to other units, such as school districts and counties, would be terminated.

- The administration's current estimates for the funding for PILT placement payments, $7.5 million in FY 2004-05, may be too high.

Reduction in Statutory Revenue Sharing Payments. The Governor's budget recommendation for FY 2004-05 revenue sharing payments totals $1.135 billion, a 15% decrease from the current appropriation and a 13.7% reduction from the payments forecasted based upon the January 2004 consensus revenue estimates.

- Approximately $183.5 million of the $200.4 million reduction reflects proposed reductions in the payments to counties, while virtually all of the remainder reflects that FY 2003-04 payments will be below the appropriation.

- Of the portion distributed to cities, villages and townships, the administration estimates $7.5 million would be used to fund PILT reimbursements. Combined with the recommendation for statutory revenue sharing payments of $443.5 million, non-PILT-related statutory revenue sharing payments to CVTs would be 99.3% of the payment received in FY 2003-04.

- Not all local units will receive a payment that is 99.3% of the FY 2003-04 payment. Approximately 240 local units would receive a 4.3% increase because they are estimated to cease receiving statutory revenue sharing payments during FY 2003-04. As a result, their total payment, excluding PILT replacement payments, would grow at the same rate as sales tax revenue, currently estimated at 4.3%.

- Under the administration's estimates, approximately 740 local units would no longer receive a statutory revenue sharing payment. Excluding PILT replacement payments, revenue sharing payments to approximately 500 of these local units would be between 99.3% and 104.3% of their FY 2003-04 payment.

Combined with the changes in county payments and the PILT replacement, statutory revenue sharing payments would be $538.9 million below the "fully-funded" level.

Hold-Harmless Grants to Units With Emergency Financial Managers. Local units under the control of a State-appointed emergency financial manager (Flint, Hamtramck, Highland Park) received $1.5 million in grants to hold them harmless from the revenue sharing reductions in FY 2003-04 (Executive Order 2003-23). The Governor's budget recommends again providing $1.5 million in hold-harmless grants. The grants would be funded by the General Fund rather than restricted sales tax revenue.

Table 11

Actual and "Fully Funded" Revenue Sharing Payments
Actual FY 2000-01 through Estimated FY 2004-05
(dollars in millions)

Fiscal Year	Estimated Fully Funded	Percent Change	Actual Payments	Percent Change	Effective Reductions
2000-01	$1,555.5	2.3%	$1,555.5	6.4%	$ 0.0
2001-02	1,571.3	1.0%	1,517.3	(2.5)%	(54.0)
2002-03	1,597.9	1.7%	1,451.4	(4.3)%	(146.5)
Est. 2003-04[a)]	1,605.0	0.4%	1,315.3	(9.4)%	(289.7)
Est. 2004-05[b)]	1,674.3	4.3%	1,127.9	(14.2)%	(546.4)

a) FY 2003-04 and FY 2004-05 estimates are based upon the January 2004 consensus revenue estimates, adjusted for Executive Order 2003-23 and House Bill 4367 of 2003, as enrolled. Actual payments will differ from the estimates presented depending on how actual revenues differ from the January 2004 estimates.
b) FY 2004-05 estimates exclude $7.5 million in payment to replace payments in lieu of taxes (PILT) to selected local units, as well as $1.5 million in home harmless grants funded from the General Fund to units with State-appointed emergency financial managers.

Table 12

FY 2004-05 Tobacco Settlement Appropriations (actual dollars)			
Merit Award Trust Fund			
Department/Program	**FY 2003-04 Year-to-Date**	**FY 2004-05 Governor's Rec.**	**Gov's Chg to FY 2003-04 Year-to-Date**
Community Health			
Medicaid Base Funding	$34,000,000	$97,200,000	$63,200,000
Education			
Michigan Education Assessment Program	0	13,685,200	13,685,200
Higher Education			
Merit Award Scholarships	67,000,000	67,000,000	0
Tuition Incentive Program	9,250,000	10,250,000	1,000,000
Nursing Scholarship Program	4,000,000	4,000,000	0
Operations Funding	9,500,000	9,500,000	0
Treasury			
Michigan Education Assessment Program	16,097,600	0	(16,097,600)
Merit Award Board	2,000,000	1,584,000	(416,000)
Tuition Incentive Program Administration	369,100	381,500	12,400
Michigan Education Savings Program	1,000,000	1,000,000	0
Information Technology	393,000	393,000	0
Transfer to General Fund	63,000,000	0	(63,000,000)
Total Merit Award Trust Fund Appropriations	**$206,609,700**	**$204,993,700**	**($1,616,000)**
Tobacco Settlement Trust Fund			
Department/Program	**FY 2003-04 Year-to-Date**	**Governor's Rec.**	**Gov's Chg to FY 2003-04 Year-to-Date**
Attorney General			
Legal Services	$351,800	$366,400	$14,600
Community Health			0
Senior Prescription Drug Program	30,000,000	25,500,000	(4,500,000)
Nursing Home Personal Needs Allowance	5,000,000	5,000,000	0
Senior Respite Care Services	5,000,000	5,000,000	0
Medicaid Base Funding	24,000,000	29,000,000	5,000,000
Labor and Economic Growth			
Life Sciences/Technology Tri-Corridor	0	10,000,000	10,000,000
Strategic Fund Agency			
Life Sciences/Technology Tri-Corridor	10,000,000	0	(10,000,000)
Transfer to General Fund	1,000,000	0	(1,000,000)
Total Tobacco Settlement Trust Fund Appropriations	**$75,351,800**	**$74,866,400**	**($485,400)**
Total Tobacco Settlement Appropriations	**$281,961,500**	**$279,860,100**	**($2,101,400)**

State Employee Funding Increases

The Governor's budget recommendation includes additional funding for State departments to provide for the previously negotiated pay increases and the associated fringe benefit cost increases for State employees. During FY 2003-04 the enacted State budget did not include funding for State employee cost increases. These cost increases were offset by a variety of concessions agreed to between the State employee unions and the Office of the State Employer. The FY 2004-05 budget recommendation includes funding for FY 2004-05 wage increases, insurance cost increases, retirement contribution cost increases, worker's compensation costs and the funding for the building occupancy costs for the office spaces occupied by State employees. State employees are scheduled to receive a 4.0% increase in their salaries on October 1, 2004. This salary increase also impacts on the amount of funds the State must contribute to the Defined Benefit and Defined Contributions retirement systems that all State employees participate in.

The budget recommendation does assume that State employees will give up a portion of their wage increases through concessions that will be negotiated by the Office of the State Employer and the State employee unions. The cost built into the Governor's budget for State employee funding increases include:

Table 13

Governor's FY 2004-05 Budget Recommendation
State Employee Funding Increases
(millions of dollars)

	Gross Appropriations	GF/GP Appropriations
Salary and Wage Costs......................................	$191.5	$100.9
Insurance Costs...	62.2	33.6
Retirement Costs...	204.4	112.0
Worker's Compensation Costs...........................	(3.3)	(2.9)
Building Occupancy Costs.................................	(14.2)	(6.6)
Total Employee Costs......................................	**$440.6**	**$237.0**
Proposed Employee Concessions	$(147.9)	$(76.2)
Net Employee Cost Increases............................	$292.7	$160.8

Higher Education

Tuition Restraint Policy. The Governor's recommendation includes a tuition restraint policy for Michigan public community colleges and universities. The proposal was first developed during deliberations on Executive Order 2003-23, and language was included in Public Act 237 of 2003 that restores, during FY 2003-04, 3.0% of the 5.0% Executive Order reduction to each community college and university that meets the following criteria:

a) The institution did not adopt a resident undergraduate tuition and fee rate increase after December 1, 2003 for academic year 2003-04;
b) The institution certifies that it will not adopt a resident undergraduate tuition and fee rate increase for academic year 2004-05 that exceeds the increase in the fiscal year 2004-05 Detroit Consumer Price Index as estimated at the January 2004 Consensus Revenue Estimating Conference.

The Governor's recommendation assumes that all colleges and universities will comply with the tuition restraint policy for both academic years 2003-04 and 2004-05. The Governor's budget adds 3.0% to the FY 2003-04 base appropriation for each college and university, and provides no increase for FY 2004-05. If a college or university fails to meet the tuition restraint criteria, their FY 2003-04 base appropriation would be reduced by 6.0%. The Governor's budget also alters slightly the criteria for measuring the Detroit CPI, by eliminating the reference to "fiscal" year 2004-05, which could allow use of either "calendar" or "fiscal" when measuring the Detroit CPI change. The January 2004 Consensus Revenue Conference estimates for the fiscal and calendar year changes for the Detroit CPI are 2.3% and 2.4%, respectively.

Elimination of Tuition Grants. The Governor proposes to eliminate the $64.8 million in funding for Michigan Tuition Grants which are need-based grants for students attending Michigan's independent colleges and universities. The Tuition Grant Program was created by Public Act 313 of 1966 and provides approximately 32,500 awards annually.

Michigan Merit Award Program. Although the Governor's budget retains for FY 2004-05 the same $67 million funding level as FY 2003-04, there are two changes recommended for the Merit Award Program that would affect FY 2005-06 appropriations:

a) Beginning with the high school graduating class of 2005, a community service requirement is added;
b) The elimination of the middle school Merit Award supplement, ranging from $250 to $500 per qualified student, is proposed. The high school graduating class of 2005 would have been the first class eligible to receive the supplement since these students would have been 7th graders in academic year 1999-2000, the first year of the Merit Award Program.

Corrections

Overall the Executive Budget proposes a $118.8 million (7.0%) increase in Gross funding and a $133.7 million (8.3%) increase in GF/GP funding from the current year-to-date appropriation for the Department of Corrections (DOC). The $150.4 million in economic increases alone are higher than the total DOC GF/GP funding increase. Other significant increases include almost $18.0 million to replace Federal funding at the Michigan Youth Correctional Facility, $12.1 million to fund salary step increases for high seniority staff, and $5.6 million for a new Hepatitis C testing and treatment line. The recommendation mitigates these costs with decreases which include over $45.1 million in employee-related savings and $12.8 million in staff reductions which will be feasible due to increases in security technology. The DOC also proposes efficiencies to compensate for a major portion of the FY 2003-04 budgetary savings negative appropriation of almost $14.9 million. Finally, efficiencies created by a prison closure, multiple facility conversions including lowering security levels and double-bunking as well as re-opening closed beds would result in a net increase of almost 700 beds while actually saving approximately $6.5 million.

The prison bed changes will include re-opening 580 minimum security beds closed in recent Executive Orders in Jackson and in Caro and also adding 200 beds at Camp Lehman. The plan also converts Level V beds to Level IV so they can be double-bunked at the Oaks Correctional Facility, and replaces the Level V beds by converting the Ionia “Supermax” Facility from a Level VI to a Level V, while still maintaining a segregation unit in order to house offenders who need a higher security level. This will provide enough beds to allow the DOC to convert the Huron Valley Correctional Facility, which houses only 500 prisoners, to the mental health and forensic center. Most of the existing offenders there will be transferred to other men’s facilities. The DOC may continue to run a residential mental health treatment program for 200 offenders there and will also transfer in the 200 offenders with severe mental health issues currently under the care of the Department of Community Health (DCH) at the nearby Huron Valley Center. The DCH will continue to run the program but from the current men’s facility location. The Huron Valley Center then would be converted back to a women’s facility as it was originally in order to house the minimum security women offenders from the Western Wayne Facility. The DOC has proposed the demolition of the Western Wayne Facility due to an aging structure and environmental problems.

The DOC budget, prison bed needs, and recent population projections are all based on a proposal which would revise sentencing guidelines in order to limit the growth rate of the prison population in two ways. First, it would require that judges use sentencing guidelines when sanctioning probation violators. Currently judges have complete discretion in sentencing probation violators who make up almost 30% of prison intake. Second, it would revise the straddle-cell portions of the sentencing guideline grids for mid-level felonies (felony classes D, E, and F) by reducing the pool of offenders whose minimum sentence score currently allows judicial discretion between a prison sentence and a local sanction. This would mean more offenders would be sanctioned locally, and two new programs would provide funding through the Community Corrections grant process in order to provide additional support to local units with existing state revenue. Proposed legislation needed to implement the changes is not yet available, but the budget recommendation assumes an implementation date of June 2004 in order to meet the population growth assumed in the budget. According to the DOC, if the proposal is adopted, it would prevent the need for funding almost 400 more beds in FY 2004-05 and save over 1100 beds in FY 2005-06.

Community Health

The Governor's FY 2004-05 Department of Community Health (DCH) budget reflects a decrease of $191 million GF/GP, when one excludes economic adjustments, but that reduction is really a combination of three major types of changes: Medicaid base and fund source adjustments, Medicaid program reductions, and fund source shifts. While the net result is a significant decrease in GF/GP funding, the amount of GF/GP and GF/GP equivalent funding in the DCH budget actually is increased significantly.

The decision to place Tobacco and Estate Tax revenue in the Medicaid Benefits Trust Fund means that the Tobacco and Estate Tax dollars are treated as Restricted revenue rather than as GF/GP. This leads to the appearance of a large GF/GP reduction in DCH, while the amount of GF/GP and GF/GP equivalent funding would actually increase by almost $400 million.

Medicaid Base and Fund Source Adjustments. The Executive budget makes a Medicaid base and fund source adjustment of $450.2 million GF/GP. This includes a $109.8 million GF/GP increase in Medicaid base funding for Medicaid physical health, mental health, and substance abuse services. The change in the Medicaid match rate from the enhanced rate of 58.10% in FY 2003-04 to the FY 2004-05 rate of 56.71% would increase costs by $102.6 million GF/GP. The failure to implement the pharmacy Quality Assurance Assessment Program (QAAP) increases costs by $18.9 million GF/GP. Finally, the continued phase-out of special financing mechanisms would increase GF/GP costs by $152.6 million. It should be noted that the Governor's recommendation assumes rejection of President Bush's proposal to eliminate certain special financing mechanisms. If the President's proposal is enacted by Congress, GF/GP costs in FY 2004-05 would be at least $200 million greater than assumed in the Governor's budget.

In addition to these base and fund source adjustments, the administration is proposing the imposition of "actuarially sound" capitation rates for Medicaid health maintenance organizations (HMOs) and Medicaid Community Mental Health (CMH) services. The administration estimates that HMO rates would increase by 15% and that CMH rates would increase by 4%. Due to the significant cost of these increases (a total of over $130 million GF/GP), the administration will seek a waiver that would allow them to phase in the increase over two years. The proposal is to pay a 7.5% HMO increase and a 2% CMH increase in FY 2004-05, then make a retroactive payment in FY 2005-06 to cover the other half of the increase. This would result in a net FY 2004-05 increase of $66.4 million GF/GP. It would also require a $132.7 million GF/GP increase from FY 2004-05 to FY 2005-06 in order to cover the cost of bringing up the HMO/CMH rates to the full 15%/4% increase level for FY 2005-06, plus to cover the remaining retroactive 7.5%/2% increase for FY 2004-05.

The net effect of these increases is a $450.2 million GF/GP increase in the Medicaid budget.

Medicaid Program Reductions. The Executive Recommendation includes $97.2 million Gross; $64.3 million GF/GP in Medicaid program reductions. These reductions include, but are not limited to, implementation of a QAAP for group homes for the developmentally disabled, implementation of gainsharing for the HMO QAAP, elimination of coverage of nursing home hospital leave days, and a reduction in Medicaid physician emergency room reimbursement rates.

Fund Source Shifts. The Executive Recommendation includes three major fund source shifts, where Restricted and Tobacco Settlement funds would be added to the DCH budget, thus supplanting GF/GP revenue. The largest of these is taking $419.1 million in tobacco tax revenue and placing it in the Medicaid Benefits Trust Fund, from which it would be used to supplant GF/GP. This $419.1 million is significantly larger than the estimated revenue from the proposed $0.75 per pack tobacco tax increase; it would mean dedicating other tobacco tax revenue to the Medicaid Benefits Trust Fund. Secondly, all the revenue from the proposed reinstatement of the estate tax, $94.3 million, would be put into the Medicaid Benefits Trust Fund and used to supplant GF/GP. Finally, there would be an increase of $63.7 million in the amount of Tobacco Settlement dollars used to support the Medicaid base. The net impact of these fund source shifts would be to reduce GF/GP funding by $577.1 million.

It should be noted that due to the transfer of the tobacco tax funding and the estate tax funding to the Medicaid Benefits Trust Fund, the increased funding is classified as Restricted revenue, not GF/GP. If the additional tax revenue had been appropriated directly, then the revenue would have been treated as GF/GP and the DCH budget would have seen over a $300 million increase in GF/GP funding. By transferring the new tax revenue to the Medicaid Benefits Trust Fund and thus making it Restricted revenue, the Governor's Recommendation shows a large decrease in GF/GP funding.

Another way of looking at the DCH budget would be to examine the GF/GP and GF/GP equivalent funding used to support Medicaid. The year-to-date FY 2003-04 GF/GP funding for DCH is $2,652,980,300. The Medicaid program is also supported by $58,000,000 in Tobacco Settlement revenue, $38,524,700 in Healthy Michigan Fund revenue, and $25,000,000 from the Medicaid Benefits Trust Fund, for a total of $2,774,505,000 in GF/GP and GF/GP equivalent funding.

The Governor's proposed FY 2004-05 DCH budget contains $2,476,079,000 in GF/GP funding, a decrease of over $176 million GF/GP from FY 2003-04. But when one considers that $419.1 million in Tobacco tax funding and $94.3 million in estate tax revenue were transferred to the Medicaid Benefits Trust Fund, to be combined with the $25.0 million already there, the total of GF/GP and GF/GP equivalent funding increases greatly. The Governor's proposal for FY 2004-05 shows the Medicaid program being supported by $121,700,000 in Tobacco Settlement revenue, $36,821,800 in Healthy Michigan Fund revenue, and $538,400,000 from the Medicaid Benefits Trust Fund, for a total of $3,173,000,800 in GF/GP and GF/GP equivalent funding.

This means that GF/GP and GF/GP equivalent funding for DCH would increase by almost $400 million from FY 2003-04 to FY 2004-05.

Healthy Michigan Fund. Due to the proposed tobacco tax increase, the Healthy Michigan Fund (which is composed of 6% of tobacco tax revenue) would see a large increase. The Governor's budget proposes using that additional revenue to increase the Smoking Prevention line by $5 million and to fund new initiatives in the Chronic Disease Prevention line and in maternal and child health at a total cost of $21.8 million. There are no details at this time as to which specific initiatives would be funded.

Transportation

The Governor's budget recommendation redirects one-half of the revenue from one cent of the gasoline tax from State bridges to the Critical Bridge Fund for local bridge projects. As part of the four cent-per-gallon gasoline tax increase in 1997, revenue from one cent of gasoline tax was dedicated for State bridge repair. The remaining three cents from the four cent-per-gallon tax increase was dedicated to State and local road agencies per the traditional PA 51 formula. The FY 2004-05 estimate of one cent of gasoline tax revenue is $51.2 million. Splitting this revenue will result in a reduction to the State road and bridge program of approximately $25.6 million annually and an increase for local bridge projects of an equal amount.

Current statutory language governing the Critical Bridge Fund allows the Michigan Department of Transportation to receive distributions from the Fund for projects on the State trunk line system. Traditionally, the Department has not requested resources from the Fund for its bridges. Under the Governor's proposed legislation, the revenue dedicated to the Critical Bridge Fund from splitting one-cent of gas tax revenue only could be distributed to cities, villages and county road commissions. In addition to the proposed funding enhancement for local road agencies, the Governor is committed to Critical Bridge Fund program reform to ensure that resources are managed cost-effectively and that the overall local bridge system condition improves.

Governor's FY 2004-05 Budget Recommendation

Senate Fiscal Agency Issues Regarding Funding

Tuition Restraint Supplemental Appropriations. Public Act 237 of 2003 provided for appropriations to universities and community colleges in FY 2003-04 totaling $52.4 million contingent upon the community colleges and the universities agreeing to tuition restraint language. The Governor's FY 2004-05 GF/GP appropriation recommendation assumes all community colleges and universities agree to this tuition restraint and the funding is built into the budget. If this occurs appropriations of $52.4 million GF/GP will have to also be made. It is unclear at this point in time what funding sources are available for this appropriation. A FY 2003-04 GF/GP projected year-end balance of $35.3 million will not be sufficient to fully fund these payments.

Tuition Tax Credit. As previously mentioned the Governor's FY 2004-05 budget recommendation assumes that all community colleges and universities hold tuition increases in the 2004-05 school year to 2.3% or less. This tuition restraint also would result in many more income tax payers becoming eligible for the tuition tax credit under the State income tax. The January 2004 Consensus Revenue Estimate only assumed a limited number of private colleges would qualify for the tuition tax credit. If all community colleges and universities qualify for this credit an additional $48.9 million of GF/GP revenue will be foregone from the increased usage of the tuition tax credit. This cost will be split so that $36.7 million impacts FY 2003-04 GF/GP revenues and $12.2 million impacts FY 2004-05 GF/GP revenues. These GF/GP revenue changes are not reflected in the Governor's budget recommendation.